

# Building Savings

in 2013





Vojtěch Lukáš, Chairman of AČSS

*Virtually every Czech family has  
a **building savings contract.***

*Dear readers, this past year, without exaggeration can be deemed as the most difficult for building savings since the scheme's inception in the Czech Republic. This reality is not lessened even by the fact that building savings banks abroad also had to deal with similar problems.*

*In the spring, discussions reached their peak regarding the preparation of an amendment to the Building Savings Act. Amongst other things it proposed that traditional commercial banks would be allowed to offer building savings but under much more preferable conditions. Despite some elements that we deemed to be positive, overall the approach was unequivocally discriminatory. However, due to political developments the hearing never reached a third reading in the parliament.*

*Not without interest was the development of opinions of most politicians across the whole political spectrum. These opinions were integrated into a number of proposals, which, had they been adopted, would mean a number of very interesting and positive changes, one example being the use of customer deposits for old-age security. This is promising for the future of the whole system of building savings, with benefits for both clients and the state.*

*Building savings banks, after three years of constant discussions and proposals that were not conceptual, and which attacked their credibility, now mainly wish for stability on the statutory front.*

*A definite complication for the building savings market is the long-term phase of very low interest rates in the financial market. However, building savings is a relatively closed system, which guarantees its customers long-term fixed interest rates. According to the law, for savings deposits they must be guaranteed for at least the length of the state support, and even for the whole length of the contract as far as loans are concerned.*

*As the chairman of the association I am convinced that during 2014 the conditions will stabilize and building savings will return to their traditional character. I also appreciate the fact that the vast majority of clients are aware of the actual situation and acknowledge the fact that at the moment on the market they will not find better conditions.*

*I wish you stable building savings.*

A handwritten signature in black ink, appearing to be 'Z. W. F. L. S.', written in a cursive style.

## Unlucky thirteen or nice twenty?

This last year culminated in the twentieth anniversary and very successful history of building savings in the Czech Republic. That alone surely would be reason for a small celebration, though, as the number thirteen indicated what might be in store, it was a year with some unfortunate factors.

In the first half of the year, discussions culminated regarding what shape this proven product will take in the future. Add to this the factor of extremely low interest rates within the whole economy, and it is evident that the conditions for building savings, one of the more conservative financial systems, were not all that favourable.

Collective results in the sector, however, indicate that 2013 could be the year where the so-called springboard effect comes into effect and building savings instead of withstanding attacks could return to their normal evolution. Along with individual indicators this optimism stems from our experience with the lowering of state support back in 2004.

The decrease in the total number of contracts is slowing down and the number of new contracts is on the rise. After three years of decreasing support most customers now know whether building savings is advantageous for them or whether under the new conditions they do not see any benefits.

Unless further factors arise that cause uncertainty, such as new discussions about what the product ought to resemble, the situation will further stabilize. If the opposite were the case, then we could not be so optimistic. We must realize that clients who use conservative financial products are especially sensitive to changes or growing uncertainty, and any 'jolts' are perceived with particular alarm.

Furthermore, no one can think that a decrease in state support did not have an effect on the number of clients. Every level of state support represents a different amount of attractiveness of building savings, not only from the perspective of total volume but also in relation to the whole economic situation.

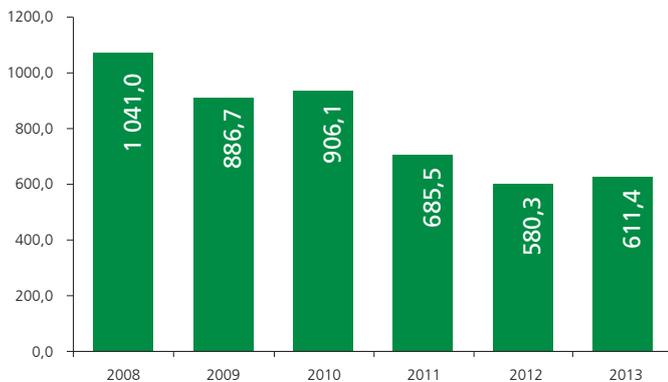
The lowering of state support always represents a lower amount of motivation for a section of our clients to use our product. Some will cease to use it altogether, because the subsidy is not high enough, and others will want to invest their funds in a different manner.

Overall we can say that the twenty year anniversary is a nice reason to not perceive the year 2013 with too much doom. Despite relatively unfavourable conditions, building savings have proved their worth and in some cases even their irreplaceability.

## More new contracts were signed ...

How building savings manages to cope with the complications that have arisen will first become apparent in the year 2014. Though one swallow does not make a summer, where else can improvement be more apparent than with the number of new contracts signed? For the first time since the amendments to the system in 2011 the number of new signed contracts has increased. This was for both new contracts (449 588) and the increase of existing contracts (161 816). In real terms this was a growth of 4% and 10% respectively.

### Number of new contracts (in thousands)



One of the reasons the number of new contracts signed has increased is the fact that a section of our customers, who had previously cancelled their building savings, have come to realize that they did not want to scratch building savings from their portfolio and are returning into the system.

## ...and there are more than 4 million contracts

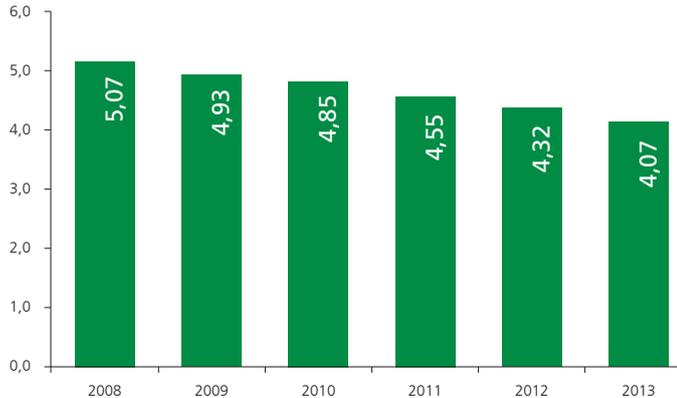
The decrease in the total number of contracts which began with the first amendments to the system in 2003 so far prevail, though the lowering of state support did not apply to existing contracts. This year there were more than two million new contracts signed.

This positive business reality from a statistical point of view cannot be seen as anything but an extraordinary occurrence, which the system has not quite absorbed yet. After all, building savings banks have on their books more than a million active contracts that were signed prior to 2004, and all this despite the fact that the amendments in 2011 also applied to existing contracts.

Of course it is impossible to claim that today's trend is solely the result of political pressure and various amendments. Its causes can be found

within the economic situation, the actual product offers of building savings banks, and the products offered by their competitors.

### Number of contracts in building savings (in millions)



The underlying signal that the amendments or extraordinary occurrences are being absorbed ought to be a constant or at least stable number of contracts in individual years. Currently it could be seen that such a situation is unattainable in the near future. But there are some parallels with the changes of 2004: there are indications that after three years the system is stabilizing.

The first three years after the amendments (in the years 2004–2006) there was a decrease in the number of contracts each year by approximately 6%. Then the decline of customers slowed down and, as could be said under the circumstances, levelled out. This levelling and its journey towards it was again rocked when further amendments were made, mainly with the reduction of state support coming into effect from the year 2011. After three years of accelerated outflow of clients for whom the system was not interesting enough, the people who have remained are those for whom, and for whatever reason, building savings is an interesting product.

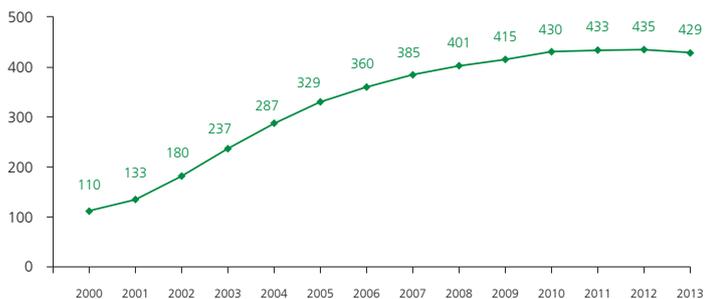
It is possible to assume that the outflow of clients will gradually slow down. The number of contracts ought to stabilize over the next few years; that is, unless the government decides on another intervention. We can assume that the whole length of the process will take approximately 10 years.

## Savings remain

More important than the total number of clients is the amount of funds that the clients have invested in building savings banks. Deposits are an essential source of resources from which loans are provided. If building savings banks had to rely on the market to generate their funds then they would have to behave as standard banks. They would

have to increase the prices for unsecured loans and would require security for such loans that they now provide without it.

### Amount of customer deposits (billion CZK)



A warning could be that for the first time in the existence of building savings banks in the Czech Republic, the volume of money invested in them has decreased. Luckily it is not too dramatic and only a slight decrease. After all, the average deposit on each contract increased over the last year by almost 5 000 CZK, to 105 518 CZK. Building savings banks repeatedly warned of the probable and long-term unavoidable decline of invested funds during consultations on probable consequences of a reduction in state support. It would

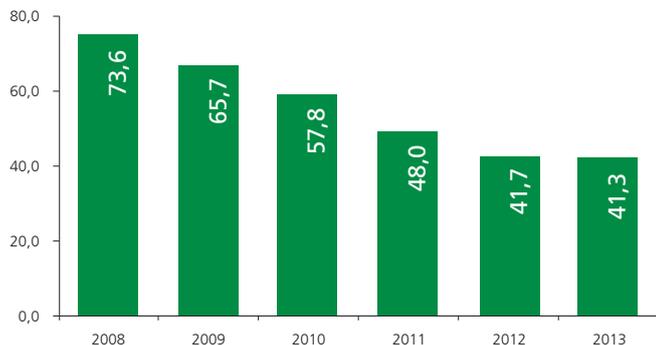
also be practically impossible for the total amount of savings to keep increasing after a decline of customers for a period of a number of years.

A positive fact is the reality that building savings survived the outflow of two million contracts before the total amount of savings decreased. What would other savings products give for such a result, where even after a reduction of a third of their active contracts they did not have any reductions in the total amount of money invested? And this is the proof of the extraordinary stability of building savings in practice. Unfortunately, a similar event at a time where there is an increase in the demand for loans could lead to a short-term shortfall in funds. It is imperative here for caution and a responsible approach by all interested parties.

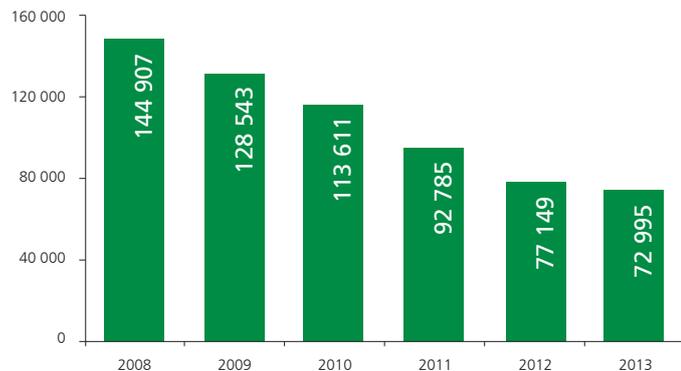
## Lending invested funds is the key

A developed country such as Germany supports building savings to assist the financing of better living conditions for the widest possible market, under conditions that are stable over the long term and at the same time more favourable than other products on the market. The foundation of the system are loans to finance housing requirements and in some other countries also education and retirement funds. However, in the Czech Republic building savings banks are only

### Volume of loans provided (in CZK Billion)



### Number of Loans provided



allowed to lend for housing purposes. And more than 41 billion CZK for the year 2013 alone is not an inconsiderable amount.

The neglected housing fund requires such a contribution to increase housing quality. The decreasing trend of the previous years, in both their financial volume and actual number of loans, has essentially ceased. In an era of low interest rates this is another sign of a turnaround towards better times. Hopefully, the following years will prove this trend to be true.

The graph primarily indicates that building savings, in the last few years, do not give out as many loans as previously. However, no one can assume that after a reduction in two million clients and in uncertain times with low interest rates, where building savings are naturally less active, that lending corporations will be breaking records. Even so, compared to 2012 the average loan has grown by 5% to 565 490 CZK, which is more than annual inflation. And that is definitely a positive thing.

An appropriate question for assessing whether building savings have any value is the number of loans and their character. Aside from a moderate fall in the number of loans provided, we cannot ignore the fact that almost 73 000 people improved their housing conditions. The benefits are amplified by the fact that the largest portion of loans goes towards purposes where banking products are

either more expensive or completely unattainable, typically towards home refurbishments and modernizations. The share of loans going towards such purposes over the long-term hovers around the 45% mark and in 2013 it was 44.1%.

## No one can do unsecured loans better than us

What may be true for housing loans secured by property, where there are accessible and competitive alternatives on the market, definitely does not apply in the category of loans not secured by property. The offer of such loans provided by building savings banks is absolutely without competition, both with respect to interest rate and loan maturity.

Consumer loans are usually not offered beyond a five-year-term, whereas building savings banks allow for loans to be repaid over a much longer period. Thus the burden on the household budget regarding repayments is much less with a building savings bank than with an ordinary consumer loan.

The differences are not caused by the price politics of the banks, but from the building savings structure, which does not have to take completely into account the uncertainty of the market. A stabilizing component, which allows for more favourable loans even without property as assets, is the state backing, which assists with the savings inflow – which is the capital for the loans.

The positive influence of building savings on the quality of the housing stock over the long term is more evident in the category of loans unsecured by real property. Though such loans do not reach staggering volumes, they are an irreplaceable instrument in financing the modernization of the housing stock.

Another growing challenge is the current requirement to reduce energy demands of housing. In both of these sectors the Czech Republic still has a very noticeable debt in the housing stock.

People also approach building savings banks for loans to purchase cooperative apartments or renovate their leased apartments. Because it is impossible to pledge such apartments as security with the banks, a loan from a building savings bank is their only option. The total results for the year 2013 are shown in the table below.

## Comparison by number and volume

	Building savings	Mortgages
Number	72 995 (47%)	82 961 (53%)
Volume (CZK billion)	41.3 (23%)	141.7 (77%)

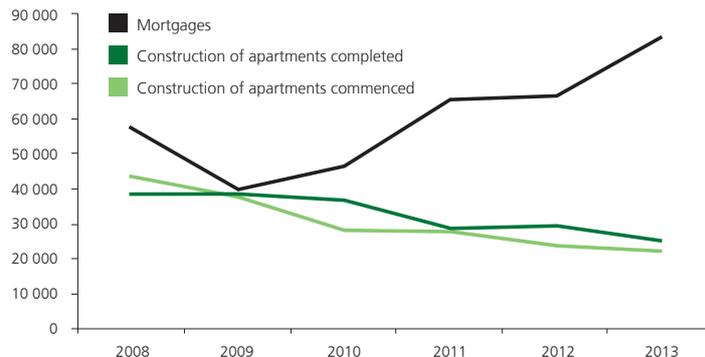
According to the statistics, in 2013 of all people who decided to get a loan to assist them with their housing needs, 47% borrowed from building savings banks. Because in most cases the loans are relatively small, building savings loans account for 23% of the volume.

## Statistics are heavily influenced by refinancing

A visible majority of mortgages does not contribute to the building of new properties, as may seem to be the case at first glance. Though clients are currently leaning more often towards mortgages, a growing number of loans is for refinancing purposes. Naturally, a share of the mortgages serves to purchase existing properties and thus have no influence on new building projects, but this has always been the case

and it has no bearing on trend changes, also because people who sell older properties usually purchase a different property, often a brand new one.

## Development in building industry in relation to mortgage loans



Why then don't mortgages in the last few years have such a major impact on the building industry, and why does the graph clearly show a scissors effect? It is because a considerable amount of mortgages serve to refinance and pay out existing ones.

Building savings banks could also refinance loans, but currently this type of action does not make economic sense. The answer once again lies in the record low interest rates, where the current mortgage offers are more favourable, even in comparison with mortgages that were offered three or five years ago.

An informed client will then rationally take advantage of more favourable conditions and at the first opportunity will refinance their loan. Statistically a new mortgage is created, also the total volume of loans increases, but no new property is built from these transactions.

Such mortgages are only a number within the statistics and demonstrate the productivity of the banking sector, although with little effect on the building sector. The number of mortgages closed to refinance is displayed by the difference between the black and green curves in the above graph. According to various estimates, it is a third, and the most pessimistic estimates claim that up to a half of all new mortgages are taken out to refinance existing ones.

We will not get an exact number from the curves, but the given estimates will not be too far from the truth. Once again: this is a phenomenon that is absolutely normal; it just needs to be interpreted correctly so as not to blindly accept the statistics given.

## Everything is connected

For the building savings sector it is crucial for the demand for loans not to markedly exceed the volume of accessible resources – the clients' deposits. For the short term any shortfall of resources could be covered by borrowing from the interbank market. However, over a longer period this would mean a move away from a proven system of building savings towards classical banking. It must therefore apply in the long term that the **total deposits cover or preferably exceed the total amount of money lent out**.

The standard indicator for evaluating whether there are substantial funds and also the effectiveness from the point of usage of cumulative resources is the ratio between loans over total deposits. As the table shows, the standard requirement of at least 60% has over the long term been complied with by the building savings banks.

### Credit / deposit ratio (in percent)

Year	2008	2009	2010	2011	2012	2013
Ratio	56.7	64.4	68.2	67.6	64.9	60.9
Growth	10.1	7.7	3.8	-0.6	-2.7	-4.0

The fact that there is an adequate pool of funds is definitely positive news for clients who are considering a future loan. In general a quicker solution for applicants of loans, who either cannot or do not want to wait for an entitled loan from the building savings, is a bridging loan. That is under the assumption that the stabilizing system is not swayed by any exterior circumstances.

## Summary

- The building savings system after a number of years of uncertainty is beginning to stabilize. A number of statistics indicate this trend.
- The number of contracts signed increased by 5% to 611 404. However, the total number of contracts is decreasing.
- For the first time in history the volume of deposits has decreased. At the end of the year there was 429 billion CZK deposited in building savings banks. The average amount of deposits was 105 518 CZK.
- Low interest rates are keeping the transactions relatively low. There were 72 995 loans signed, for a total of 41.3 billion CZK. Mortgages are currently doing better, but refinancing is distorting the statistics.
- There are enough resources for further lending and the system is lending effectively.

## 20 years of commitment or not?

In 2013 building savings celebrated its 20 year anniversary in the Czech Republic. Its creation at the beginning of the 1990s was not an accident. The-then government of Václav Klaus was not only faced with low levels of savings, but above all by the enormous neglect of the housing stock created by 40 years of socialism. Experts estimated the internal debt in this sphere to be hundreds of billions of Czech crowns.

At the same time our two western neighbours had a long-standing and reliable product, that motivated people towards long-term savings which substantially assisted in financing housing requirements. And building savings, so successful in Germany and Austria, was also formed in 1993 in the Czech Republic.

Building savings became a welcome opportunity to quickly find missing resources for those who needed to quickly invest in housing. That is also why there was generous state support, with a maximum subsidy of 4 500 CZK. Few people expected that this very system would so quickly be so broadly accepted and become so widespread, that practically today almost every family has a building savings account.

Apart from millions of people using the product to save their funds, the number of people taking out loans also quickly grew. By the end of 1999 almost 300 000 people were repaying their loans while another 2.8 million were using it to store their savings. Building savings was going through an extreme growth period and its popularity was no longer necessary to support with such high state subsidies.

### First constrictions

In 2003, after 10 years of existence, the government of Vladimír Špidla lowered the state subsidy down to a maximum 3 000 CZK for each person. From today's perspective this change seems logical and the public's further interest in this product confirmed this. However, there were never again as many savings accounts as at the end of 2003, to be precise, 6 300 821.

The state expenses for subsidizing the scheme still grew for the next two years, but since then they have been on the decline. Conversely the volume of loans taken out kept growing. The state had a strong and effective tool, thanks to which every Czech crown

of state support had a multiplier effect on the funds going into the housing market, and subsequently the tax revenues collected by the government. Building savings developed into a phase where the state, thanks to a multiplier effect, each year collected more revenue from taxes than it invested in the form of subsidies.

Building savings were shown in an even better light at the time when the financial markets collapsed under the weight of mortgages not only in the USA but practically all over the world. Here the volume of mortgages also thinned out, for banks became more cautious, and as a result the building sector also slowed down. Building savings, thanks to their structure, were the exception to this trend.

The building savings system is based on the collective principle. Funds for loans are firstly required to be saved with the assistance of many clients. All the while we are talking about actual money and not some virtual numbers on the screen of some stock broker's tablet. While in the time of recession, money is expensive for the banks (only a few institutions will lend and at higher interest rates), on the building savings market, little changes.

### Stable results even through years of recession

In other words, building savings banks did not have to change their business model too much, and customers could be sure that, at least in this sector, they have their usual certainty. Abroad, it was a similar situation, where the differences between building savings banks and classical banks were even more pronounced. The domestic banking sector handled the recession much better, also because it went through an extensive state sanitation.

The volume of mortgages in 2008 fell by 17% as opposed to the previous year, while loans from building societies grew by 1.5%. In 2009 the whole loan market decreased, but mortgages decreased threefold as opposed to loans from building societies. It showed that building savings are extraordinarily stable and not as sensitive as classical bank products when turbulent changes occur.

However, the situation began to change in the following years. The recession slowly subsided and building savings that had played the role of economic stabilizer naturally released their market share to the resurging mortgage market. In 2010 the-then government

decided to again lower its subsidies, this time to a maximum of 2 000 CZK per person.

If we add the strong negative influence of inconsistent discussions that were considering changing the system, which was to further detract customers by debating creating a totally new and untried system, then we cannot be surprised by the subsequent decline. In the end no changes were approved, but the outfall of all these debates was tangible: basically all the main indicators for building savings worsened.

The pressure from the state, though, was not the only factor in this situation. The business results were more influenced by the almost zero percentage interest rates on the market. It is quite obvious that in these times, the institutions that borrow their finances on the money market have an advantage.

Opposed to this, building savings banks get their finances from their clients and can only operate with them within the boundaries of the law. Of course the state's support greatly assists them; even so, the return savings offered are above standard.

## Historical commitment

The situation of building savings is currently a little bit more complicated. The system has gone through a period where it had to persevere through the most extensive pressure in its twenty year history, during which it repeatedly demonstrated its extraordinary resistance resulting from its historically defined principles. Building savings came into existence as a collective system to finance housing requirements. Interested parties could either wait until they saved up the necessary funds, or they could come to an agreement and purchase their first home. And what if they came to an agreement with those who did not need to purchase anything? One party invested their money in return for interest rates and other benefits (e.g. state support) and the other party could get their funds required to purchase their home. That is how an effective and today a long-term proven system came into being: **building savings**.

The countries by which we were inspired have even gone a step further. They have taken a proven product and begun to use it to finance other identified requirements such as education and old

age security. In modern European states nobody thinks twice about the fact that this system is still called building savings. No one will take its historical name away anymore, because it was the housing and building sector that the system was first applied to, and it has proven itself with its more than one hundred year stability.

It is this stability that is one of the main keys of this product: building savings loan repayment amounts remain the same, there are no fixed terms or floating interest rates based on some indicator. A savings contract already includes an interest rate amount for which the client will be able to borrow funds in the future.

After all, it is this stability that also represents a commitment to the future, so that more than 2 million loans with a total value of 661 billion CZK and almost 15 million contracts signed is not simply a trip down a blind alley.



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in 2013



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